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December 17, 2004

Mary L. Cottrell, Secretary
Department of Telecommunication and Energy
One South Station, 2nd Floor
Boston, MA 02110

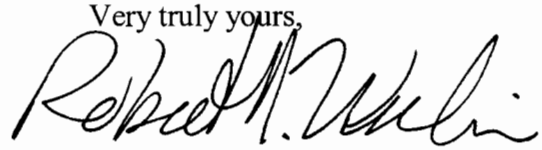
Re: D.T.E. 04-70 — Petition of Boston Edison Company and Commonwealth Electric Company d/b/a NSTAR Electric for Approvals Relating to the Issuance of Rate Reduction Bonds Pursuant to G.L. c. 164, § 1H

Dear Secretary Cottrell:

Enclosed please find the Reply Brief of Boston Edison Company and Commonwealth Electric Company d/b/a NSTAR Electric in the above-referenced proceeding. Also enclosed is a certificate of service.

Thank you for your attention to this matter.

Very truly yours,



Robert N. Werlin

Enclosure

cc: Service List
Joan Foster Evans, Hearing Officer

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Boston Edison Company Commonwealth Electric Company	)	D.T.E. 04-70

CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing document upon the Department of Telecommunications and parties of record in accordance with the requirements of 220 C.M.R. 1.05 (Department's Rules of Practice and Procedures).

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Dated: December 17, 2004

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Boston Edison Company and Commonwealth Electric Company d/b/a NSTAR Electric, for Approvals Relating to Issuance of Rate Reduction Bonds Pursuant to G.L c. 164, §§1G and 1H	D.T.E. 04-70

REPLY BRIEF OF BOSTON EDISON COMPANY AND COMMONWEALTH ELECTRIC COMPANY d/b/a NSTAR ELECTRIC

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Dated: December 17, 2004

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REPLY BRIEF OF BOSTON EDISON COMPANY AND COMMONWEALTH ELECTRIC COMPANY d/b/a NSTAR ELECTRIC

I. INTRODUCTION

Boston Edison Company ("Boston Edison") and Commonwealth Electric Company ("Commonwealth", and together with Boston Edison, the "Companies") file this reply brief to respond to the initial brief of the Attorney General of the Commonwealth of Massachusetts (the "Attorney General") in the above-referenced proceeding before the Department of Telecommunications and Energy (the "Department"). This case was filed by the Companies pursuant to G.L. c. 164, §§ 1G and 1H, the Boston Edison Restructuring Settlement Agreement (the "Settlement Agreement") approved by the Department in D.P.U./D.T.E. 96-23, and Commonwealth's restructuring plan (the "Restructuring Plan") approved by the Department in D.P.U./D.T.E. 97-111 and D.P.U./D.T.E. 97-111-A, for approvals relating to the issuance of rate reduction bonds to provide for the securitization (as such term is used in G.L. c. 164, §§ 1G and 1H) of approximately $675 million of reimbursable transition costs amounts consisting of the payments associated with the termination of obligations under certain power purchase agreements (the "PPAs") between the Companies and MASSPOWER and between

Commonwealth and Dartmouth Power Associates, L.P. ("Dartmouth"), the recovery of certain transition costs of Commonwealth pursuant to the Restructuring Plan, transaction costs arising in connection with the issuance of the RRBs, and the provision of any required credit enhancement (the "Petition").

In two related proceedings (the "Related Proceedings"), the Companies petitioned the Department to approve the PPAs buyouts. In D.T.E. 04-61, the Companies requested that the Department approve the termination of the MASSPOWER PPAs and associated ratemaking treatment and find that the PPA buyouts are consistent with the Restructuring Act, the Settlement Agreement, in the case of Boston Edison, and the Restructuring Plan, in the case of Commonwealth. In D.T.E. 04-78, Commonwealth requested that the Department approve the termination of obligations to purchase electricity under the Dartmouth PPA and associated ratemaking treatment. In the Related Proceedings, the Companies have requested the Department to find that the buyouts, including the associated securitization, are likely to achieve savings and are otherwise in the public interest and are consistent with the Companies' obligation to mitigate transition costs to the maximum extent possible. In this proceeding, the Companies request approvals to securitize, among other transition costs, the liquidation payments associated with the PPA buyouts. Approval by the Department of securitization is a condition to the PPA buyouts. Similarly, unless and until the Department authorizes the PPA buyouts in D.T.E. 04-61 and D.T.E. 04-78, the liquidation payments associated with the PPAs buyouts will not constitute transition costs and may not be securitized.

The Attorney General argues that the Companies' Petition should be rejected in part and limited in part. The Companies believe that the Attorney General's arguments are without merit

and are addressed below.[1]

II. ARGUMENT

A. The Dartmouth Agreement Maximizes Mitigation of Commonwealth's Transition Costs and Provides Substantial Projected Customer Savings.

The Attorney General repeats his assertion made initially in D.T.E. 04-78, that the Dartmouth contract buyout payment be excluded from the principal amount to be securitized.[2] His argument is that, even though customers will receive a projected $13 million net-present-value ("NPV") in savings, the buyout amount, if considered separately, would not provide customer mitigation. The Attorney General's argument is flawed because: (i) it fails to evaluate the terms of the renegotiated PPAs on the basis of whether there is an overall net saving to the customers measured as "reductions in the transition charges" levied upon and paid by customers; and (ii) it neglects the fact the securitization of the buy-out amounts is a condition precedent to the consummation of the Dartmouth Agreement (Exh. NSTAR-1, Appendix A at 4-5. [D.T.E. 04-78]).

The Attorney General ignores the fact that G.L. c. 164, § 1G(d)(2)(i) does not specify how a company mitigate above-market costs to achieve reductions in transition charges, only that it do so. In the case at hand, Commonwealth has achieved a reduction in transition costs through a renegotiation of the Dartmouth PPA that turned a stream of above-market payment that were

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[1] In responding to the Attorney General's initial brief, the Companies will not repeat arguments at length that were addressed in the Companies' Initial Brief. Silence on any matter raised by the Attorney General does not indicate the Companies' agreement to any issue raised by the Attorney General. The Companies expressly reassert the positions and arguments set forth in their Initial Brief.

[2] The Companies have briefed this issue in response to the Attorney General's arguments in D.T.E. 04-78. See Companies Reply Brief at 2-8 [D.T.E. 04-78]. The Companies will not repeat all of those arguments here, but note that the Attorney General, in his initial brief in this proceeding, has not responded to any of the Companies' rebuttals contained in the Reply Brief in D.T.E. 04-78.

not capable of being securitized, into a fixed-payment amount that was capable of being securitized, resulting in a significant reduction in transition costs as mandated by the Restructuring Act. The Attorney General cites no reason why this is not an acceptable form of mitigation contemplated by G.L. c. 164, §1G(d)(2)(i).

Further, the Restructuring Act requires electric companies to negotiate with their purchase-power contract counter-parties "in order to achieve reductions in transition charges," and provides that where the Department finds that the result of such renegotiation "is likely to achieve savings to the ratepayers and is otherwise in the public interest," the remaining costs "shall be included in the transition charges" to be collected from customers. G.L. c. 164, § 1G(d)(2)(i) and (ii). The proposed Dartmouth Agreement meets the above requirement of the Act because customers will receive a projected $13 million NPV in savings. There is no "stand-alone" agreement to consider in the absence of securitization. As a factual matter, savings under the Dartmouth Agreement, by its terms, include the customer savings resulting from securitization. Without the securitization of the buyout amount customers will not receive savings.

The record demonstrates that approval of the Dartmouth Agreement is likely to result in savings for customers and is otherwise in the public interest.[3] Thus, the Department should approve the securitization of the Dartmouth buyout payment and make the resulting savings available to Commonwealth's customers.

[3] In addition to providing savings to customers, approval of the Dartmouth Agreement will remove the Company from generation obligations consistent with its approved Restructuring Plan. See Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U./D.T.E. 97-111, at 64 (1998); see also Plymouth Rock Energy Associates, L.P., D.P.U./D.T.E. 99-122-B at 5-6 (1999).

B. The Proposed Term of the RRBs Is Consistent with Department Policies and Is in the Public Interest.

In their Petition, the Companies have proposed that the tranche of RRBs with the longest maturity have a scheduled maturity date of eight years and a final legal maturity date of 10 years. Transition costs represent the above-market portion of past investments associated with generation assets and power purchase agreements incurred prior to the adoption of the Restructuring Act. The Companies believe that the proposed term for the RRBs appropriately takes into account the Department's stated goal of ensuring that customers realize the benefits of reduced transition costs as soon as possible (see D.T.E. 97-111, at 75-76), while assuring that the RRB transaction results in a significant reduction in transition costs and produces associated customer savings. The Attorney General alleges that the Companies' proposal would result in intergenerational cross-subsidization (Attorney General Initial Brief at 5). However, this contention is unfounded and insupportable. The Restructuring Act requires that transition charges should be non-bypassable, i.e., that customers in general are responsible for the payment of transition costs. G.L. c. 164, § 1G(e). Moreover, the Companies' proposed securitization-payment period is applicable to each of the Dartmouth, MASSPOWER and the Commonwealth deferral costs. In the context of securitization of a variety of transition costs to produce maximum customer savings, it is impossible to match at any given time the generation of customers that would have paid a particular underlying transition cost with the customer that may pay the RTC Charge. Under the Attorney General's logic, different maturity dates would be established for RRBs related to each set of costs, which would be impossible to achieve, especially in view of the fact that G.L. c. 164, § 1H(b)(4)(vi) provides that the term of RRBs shall not extend beyond 15 years.

The length of the maturity period for RRBs should strike an appropriate balance among a number of oft-competing issues including the rate impacts on customer (now and in the future), rate continuity, intergenerational equities, as well as the timely elimination of the payment of transition costs. Although there is no precise formula that can or should be applied, the Department qualitatively balances such factors when it considers the issue of intergenerational equity. See e.g., Fitchburg Gas and Electric Light Company, D.T.E. 02-24/25, at 153 (2002); Boston Gas Company, D.P.U. 93-60-D at 4 (1994). The eight-year scheduled maturity date (with the 10-year final legal maturity date) strikes an appropriate balance of these issues in this case and should be approved by the Department.

C. Securitization of Commonwealth's Mitigation Charges Maximizes Mitigation of Commonwealth's Transition Costs and Provides Substantial Projected Customer Savings.

The Attorney General urges the Department to reject the portion of the proposal that would securitize Commonwealth's mitigation incentive (Attorney General Initial Brief at 6-7). The Attorney General argues, without record citation, that calculating the net present value of the mitigation payments using an 8.2 percent discount rate (instead of a 4.5 percent discount rate) would show a net increase in rates for customers (id.). There is no record evidence to support this proposition and, as shown in Exhibit DTE-1-6, customers benefit by $0.577 million on an NPV basis from securitizing the combination of the fixed and incentive components of the Commonwealth Transition Charge. There was no request from the Attorney General for an exhibit breaking down the share of the savings between the fixed and incentive portions; it is

very unlikely to obtain savings of $0.577 million from securitizing the $1.906 million[4] in the fixed component. The discount rate of 4.5 percent is the customer cost of money arising from the securitization and using this cost the customer obtains savings from the securitization.

Accordingly, there is no merit to the Attorney General's argument and the Department should permit the inclusion in the securitization the Commonwealth mitigation incentive in order to maximize savings to customers.

D. Commonwealth Has Fully Mitigated Its Transition Charge Under Recovery (the "Deferral Balance") and Securitization of Such Amounts Is Authorized By G.L. c. 164, § 1H(b)(1).

The Attorney General does not argue that Commonwealth's request to securitize its entire Deferral Balance should be rejected. The Attorney General concedes that there are customer benefits to securitizing the Deferral Balance but argues that Commonwealth should be allowed to securitize only $81 million of such amount "because that is the only amount the Department has approved" (Attorney General Initial Brief at 8). As discussed in the Companies' Initial Brief, the Department approved in the Restructuring Plan, Commonwealth's transition costs and transition charges that Commonwealth may collect. The Department has further determined, under G.L. c. 164, §§ 1G(e) and H(b)(2), that these transition charges be nonbypassable by customers. Although the amount of transition costs being recovered or expected to be recovered by Commonwealth during 2003 and 2004 has not yet been approved by the Department, these costs are subject to the process set forth in G.L. c. 164, § 1G(a)(2) to assure that the Department reviews and approves these costs. To the extent reimbursable transition costs amounts

[4] Exhibit DTE-1-6, Attachment DTE 1-6(a), page 8 of 8 shows that the "Net Fixed Component" in column B totals $1.906 million, representing only 9 percent of the total amount to be securitized; accordingly, it could not account for all the customer savings for the two elements.

previously included in a financing order exceed the correct amount, Commonwealth must provide customers with a uniform rate credit through the mechanism of their annual transition charge update. G.L. c. 164 § 1G(a)(2). As discussed above, the Restructuring Act clearly contemplates that not all transition costs to be securitized will have been reviewed by the Department at the time of securitization and expressly provides a mechanism to assure that customer are responsible for only the amount of transition costs approved by the Department. The point of this provision to is assure that customers can receive the benefits of securitization even though certain transition costs to be securitized may be based only on estimates at the time the RRBs are issued. In fact, in Boston Edison's initial securitization proceeding, the Department explicitly approved the securitization of estimated transition costs, subject to reconciliation. Boston Edison Company, D.T.E. 98-118, at 25-27 (1999).[5]

The Attorney General argues that the additional costs could be recovered by increasing the transition charge to 4.08 cents, the transition charge rate cap (Attorney General Initial Brief at 7-8). The Attorney General fails to acknowledge the significant savings to customers if the deferred amounts can be securitized, and the large rate increase to Commonwealth's customers that can be avoided. In the absence of securitization, the transition charge for Commonwealth would increase to 4.08 cents per kilowatthour in 2005 and 2006, as shown in Exhibit NSTAR-COM-GOL-3 page 1 Column C.

[5] In that securitization case and in the companion proceeding relating to the divestiture of generation assets, the Department permitted recovery of several categories of estimated costs (e.g., call premiums, charges under a materials contract with General Electric, recovery of the portion of stranded costs related to municipal customers, refueling outage costs) subject to those estimated costs being subsequently "trued-up" in Boston Edison's annual reconciliation proceeding. D.T.E. 98-118, at 25-28 (1999); D.T.E. 98-119, at 50, 60 (1999).

Commonwealth has demonstrated that there is a substantial reduction in transition charges, and associated customer savings, that will be achieved through securitization of the entire Deferral Balance (Exh. NSTAR-GOL-1; Exh. NSTAR-COM-GOL-2) and that any amounts that haven't been finally reconciled by the Department will be appropriately accounted for under the proposal, in conformance with statutory provisions. Accordingly, the Department should approve Commonwealth's request to securitize the entire amount of the Deferral Balance.

E. It Is Not Necessary To Include in the Financing Order a Provision For Prompt Correction of Any Errors in Calculations Included in Issuance Advice Letters.

The Attorney General argues that the Department should condition approval of the RRBs on the Companies correcting any errors in the Issuance Advice Letter (Attorney General Initial Brief at 9). His position completely misconstrues the effect of the Financing Order in arguing that "any mistakes made in that advice letter can lead to over-recoveries that remain with the SPE until its dissolution … causing great economic harm to customers" (id.).[6] The Attorney General ignores the fact that G.L. c. 164, § 1H(b)(5) already requires, at a minimum, an annual true-up of the RTC Charge (Exh. NSTAR-1-B at A-50, Findings 50 and 51). To the extent that an error in the initial Issuance Advice Letter or in any periodic Issuance Advice Letter results in over- or undercollections of the RTC Charge, those amounts are taken into account in annual or more frequent adjustment to the RTC Charge (Exh. NSTAR-EGO-5 (The adjusted RTC Charge "shall reflect (i) the shortfall or excess in recovery of the Periodic Payment Requirements

[6] Contrary to the Attorney General's assertion, there has never been a miscalculation in an Issuance Advice Letter filed in connection with Boston Edison's 1999 rate reduction bond transaction (Tr. 1, at 45-46). During 2001, an error was detected in the calculation of the transition charge resulting in an under collection of the transition charge. The correction of the error was part of the settlement with the Attorney General that was approved by the Department in D.T.E. 01-78 (Exhibit BEC-BKR-2 (Settlement) Page 6 of 7). However, there was never an error in the RTC Charge or any Issuance Advice Letter.

collected during the prior Applicable Period …")). The purpose of these periodic adjustments is to "minimize a shortfall or an excess in recoveries of reimbursable transition costs amounts …." (Exh. NSTAR-EGO at 17). Any unanticipated overcollections of the RTC Charge are deposited into the reserve subaccount. All amounts accounted for in the reserve subaccount, which represents prior collections in excess of the prior periods' Periodic Payment Requirements, at the time that a company calculates a periodic RTC Charge adjustment, are incorporated in such adjustment (Exh. NSTAR-1-B at A-25). At a minimum, such adjustments are required to be made annually, not only upon dissolution of the SPE as alleged by the Attorney General. As a result, even if there were ever to be an error in an Issuance Advice Letter, there are already mechanisms in place to avoid the "great economic harm to customers" with which the Attorney General is concerned.

Accordingly, the Attorney General's argument is without merit and should be rejected by the Department.

F. It Is Unnecessary for the Department To Require the Company To Provide Treasury Debt Interest Rates and Spreads Over Those Rates in Connection With the Initial Advice Letters.

The Attorney General proposes that the Department order the Companies to provide "in the Issuance Advice Letter the interest rates for treasury debt instruments, and associated spreads related to each maturity date, it used to determine the coupon rates at issuance" (Attorney General Initial Brief at 10). This requirement is unnecessary because the Proposed Financing Order contemplates that the Agencies will oversee the issuance of the RRBs (Initial Brief of the Agencies at 3). The Agencies will approve the final terms of the RRBs, including pricing (id.). The purpose of this requirement is to "[ensure] the all-in costs of issuing the RRBs are minimized given current market conditions" (id. at 2). Accordingly, no purpose will be served

by requiring inclusion in the Initial Issuance Advise letter of the treasury rates and spreads used to calculate the interest rate on the RRBs.

G. It Is Not Necessary To Limit the Securitization of Transaction Costs Authorized To Be Securitized by G.L. c. 164, § 1H(a) Only to Costs for Which the Company Has Received an Invoice to Date.

The Attorney General argues that the Department should authorize the securitization of only those transaction costs "invoiced to date" (Attorney General Initial Brief at 11). G.L. c. 164, § 1H(a) expressly provides that Transition Property includes the right to recover transition costs "and the costs of providing, recovering, financing, or refinancing the transition costs, including the costs of issuing, servicing and retiring electric rate reduction bonds." As an initial matter, a majority of the transaction costs, while not yet invoiced, are presently known or are based on a formula that relates to the amount of the RRBs (Exh. NSTAR-EGO at 21; Exh. NSTAR-EGO-3). With respect to other transaction costs, as discussed above, the Restructuring Act does not require that all transition costs to be securitized be invoiced prior to Department approval of the RRB transaction.[7] The Restructuring Act expressly contemplates that not all transition costs (including transaction costs) to be securitized will have been invoiced, paid or reviewed by the Department at the time of securitization and expressly provides a mechanism to assure that customers are responsible for only the actual amount of transition costs paid by the SPEs and reviewed approved by the Department. The point of this provision to is assure that customers can receive the benefits of securitization even though certain transition costs to be securitized may be based only on estimates at the time the RRBs are issued. Inclusion of the

[7] In the prior Boston Edison securitization, recovery of estimated transaction costs, including call premiums, was approved, subject to being "trued-up" in the annual reconciliation process. D.T.E. 98-118, at 22-27 (1999).

estimates of all such costs will maximize customer savings and, accordingly, the Attorney General's request should be denied.

Finally, the Attorney General argues that transaction costs not yet invoiced should be included in the variable portion of future transition charge of the Companies. However, the Attorney General's suggestion ignores the fact that these transaction costs are expenses of the SPEs, and not expenses of the Companies. The SPEs are distinct legal entities and preservation of the legal distinction between the SPEs and the Companies is important to preserve the bankruptcy remoteness of the SPEs. This is one of the reasons that the Restructuring Act includes transaction costs as part of the Transition Property of the SPE and not separately as a general transition cost.

H. The Companies Have Established an Order of Preference Such That the Transition Costs Having the Greatest Impact on Customer Rates Will Be Reduced By Securitization, as Required by G.L. c. 164, § 1G(d)(4)(v).

The Attorney General asks that the Department "order Commonwealth to use available funds from the bond issuance to reduce its capitalization and decrease its overall weighted costs of capital" (Attorney General Initial Brief at 12). As discussed in the Companies' Initial Brief, G.L. c. 164, § 1G(d)(4)(v) requires an electric company to establish an order of preference such that transition costs having the greatest impact on customer rates will be the first to be reduced by the securitization. In this proceeding, the Companies propose to securitize all of the reimbursable transition costs that the Companies believe may be securitized at this time. The Attorney General suggests that the Companies should be required to use the cash proceeds from the RRBs to "reduce its capitalization and decrease its overall weighted cost of capital to customers." However, the Attorney General's argument is completely inconsistent with the requirement in the Restructuring Act that securitization be used to reduce transition costs." The Attorney General does not in any way suggest how a reduction in the Companies' weighted

average cost of capital results in any reduction in transition costs.[8] The Attorney General's request should be denied.

III. CONCLUSION

The Companies are required by statute to provide net savings for the benefit of customers. The instant RRB Transaction will result in net savings as reflected in lower transition charges. The Attorney General would have the Department reject portions of the Companies' Petition that will result in significant reductions of transition costs with associated customer savings. Further, the Attorney General asks the Department to limit the requested approvals in ways that are unnecessary or are, in fact, inconsistent with the Restructuring Act.

For the reasons set forth herein as well as in the Companies' Initial Brief and their Petition for Approval of its Application for Issuance of Rate Reduction Bonds, and all of the testimony and information submitted by the Companies in connection with the proceedings, the Companies respectfully request that the Department approve their Application for Issuance of Rate Reduction Bonds on the terms and conditions set forth in the proposed Finance Order, Exhibit NSTAR-1-B.

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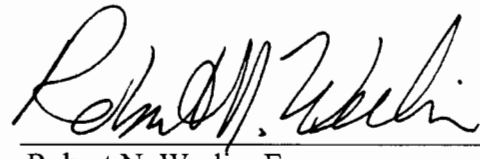
[8] The Companies are aware of a discussion in the Order issued in D.T.E. 00-40 to the effect that use of proceeds from the RRBs will be used to reduce interest expense that will be passed on to customers "through the securitization." Western Massachusetts Electric Company, D.T.E. 00-40 at 10. However, that proceeding involved Department approval of a negotiated settlement between Western Massachusetts Electric Company and the Attorney General. Although perhaps well intentioned, the negotiated settlement is not in any way consistent with the statute or precedent for this proceeding. It is impossible for the contemplated reduction in interest expense to be "passed on to WMECO's ratepayers through securitization." Further, such a reduction in interest expense has no impact whatsoever on transition costs. The clear meaning of the statute is to require that transition costs likely to generate the greatest savings to customers be the first to be securitized.

Respectfully submitted

BOSTON EDISON COMPANY
COMMONWEALTH ELECTRIC COMPANY

By their attorneys,



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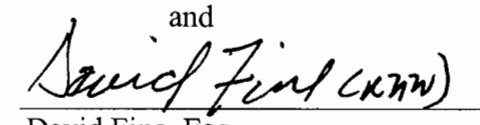

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Dated: December 17, 2004